Covad Communications

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December 9, 2002

The Honorable Michael Powell
Chairman
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: *Triennial Review Proceeding*, WCB Docket No. 01-338

Dear Chairman Powell:

In recent weeks, the Bell Operating Companies and their supporters have encouraged the Commission to significantly curtail the Commission's loop unbundling requirements in the name of "investment incentives." Specifically, the Bell companies, together with the High Tech Broadband Coalition ("HTBC"), have proposed eliminating unbundling requirements as to any loops that consist, in whole or in part, of any fiber optic cable.

As I discuss in more detail below, this proposal should be rejected, and unbundling of fiber-fed loops should be preserved, for the following reasons:

- The Bell proposal urges on the Commission an approach incompatible with the standard that Congress mandated in the Telecommunications Act.

- The "investment incentives" theory advanced by the Bells and HTBC is refuted by the empirical evidence, which demonstrates without dispute that the Bells failed to deploy DSL technology, despite its availability, for the better part of a decade, during which time they had no unbundling obligations and even by their own calculus could have reaped all of the benefits of such investments.

- The proposal would condemn significant and growing portions of the public to dependency on monopolists or duopolists for broadband services.

- The proposal carves out a sphere of monopoly well beyond what would logically follow from even the proposal's flawed assumptions.

- The record before the Commission convincingly demonstrates that the "bitstream UNE" proposed by incumbents and competitors would stimulate robust competition for customers served by fiber-fed loops. The UNE framework is well-suited to ensure pricing for the bitstream UNE that would provide fair investment incentives.

The HTBC urges the elimination of unbundling requirements for "any fiber-based facility deployed on the customer side of the central office that is used in whole or in part to transmit packetized information and the associated equipment attached thereto."[1] Notwithstanding its position on fiber loops, the HTBC does argue that "the Commission must continue to require ILECs to provide unbundled access to the legacy copper facilities."[2] Covad agrees with the HTBC that the Commission must maintain its existing copper loop unbundling rules, including lineshared loops, in order to promote competition in the provision of broadband services. Covad strongly disagrees, however, with the HTBC's position that loops that contain fiber optic cable should not be unbundled. The HTBC argues to the Commission that "[m]inimizing Section 251 unbundling obligations on new broadband facilities will serve as a significant economic incentive for ILECs to increase investment in these access facilities."[3] But then, the HTBC proposes eliminating unbundling of all loops that contain *any* fiber optic cabling – without any reference to when the fiber was put in place, the extensive legacy rights of way (granted under government-sanctioned monopoly) over which the fiber was put into place, or the dramatic cost savings incumbents enjoy as a result of fiber deployment, and the implications of those cost savings for investment incentives. For example, in its investor briefings prior to the commencement of the *Triennial Review* proceeding, SBC claimed that it would enjoy a cumulative savings of $1.5 billion by 2004 ($850 million savings in cash operating expense and $600 million savings in capital expenditures) as a result of its fiber deployments for Project Pronto.[4] In short, the HTBC believes that unbundling is unwarranted regardless of whether the fiber cabling was installed last week or two decades ago, whether the fiber is built over legacy rights of way or in previously unserved areas requiring competitive investment by the Bells, and regardless of whether fiber deployment actually reduces incumbent operating and capital expenses.

The core of the HTBC argument – that curtailment of unbundling of loops that contain fiber will promote broadband deployment by the Bell companies – is refuted by the evidence in the record before the Commission in this proceeding. As Covad demonstrated in economic testimony submitted to the Commission, the Bell companies have no incentive to innovate or to invest in their networks in the absence of adequate competitive pressure.[5] Rather, the Bell companies sought for years to avoid deploying innovative, low cost broadband services like DSL in order to avoid cannibalizing more lucrative services like ISDN and T-1.[6] Thus, even though Bell Atlantic contemplated DSL in the early 1990s, it did not deploy commercial DSL services until 1998, shortly after Covad launched service.[7] In brief, the history of DSL deployment offers an important lesson: without the spur of competition, the prospects for the introduction of new and innovative services by the Bells are at best dubious, even if the demand for those services is high.

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[1] High Tech Broadband Coalition *ex parte* notifcation, WCB Docket No. 01-338, dated November 15, 2002, at 6.
[2] *Id.* at 5.
[3] *Id.* at 5.
[4] *See SBC Announces Sweeping Broadband Initiative,* SBC Investor Briefing, at 2 (October 18, 1999).
[5] *See* Covad Declaration of Steve Siwek and Su Sun, WCB Docket No. 01-338, filed Nov. 20, 2002.
[6] *Id.* at ¶ 17.
[7] *Id.* at ¶ 30.

The basis for the HTBC's theory that loops containing fiber should not be unbundled is the assertion that "ILECs do not possess market power in the delivery of broadband services."[8] Of course, the statutory impairment analysis required by section 251(c)(3) of the 1996 Act is not premised on the retail services that the Bell companies choose to provide.[9] Indeed, if that were the case, the Bell companies would have been able to thwart entirely the deployment of DSL services – which were launched commercially by Covad before any of the Bells – merely by refusing to deploy such services into perpetuity. Guided by the statute, the Commission examines the facility in question – the loop – to determine whether competing carriers are impaired in their ability to offer telecommunications services, such as DSL, without unbundled access to loops. There is nothing on the record in this proceeding to support the notion that competing carriers are not so impaired – indeed, even the HTBC willingly concedes that, at least as to copper loops, carriers are indeed impaired and unbundling is required.[10] The record is devoid of any evidence to support the lines HTBC seeks to draw based solely on the physical nature of the material out of which the loop has been constructed, and those lines defy the parameters, based on competitive reality and common sense economics, set out by Congress in the Act.

The HTBC has suggested, in essence, that the Commission adopt a policy of technical redlining of consumers. Those consumers whose loops consist entirely of copper are entitled to a choice of broadband provider. Those consumers who have the misfortune to have loops that contain any fiber will be redlined out of that choice of competitive broadband provider. According to the FCC's own statistics, more than 20% of local loops in the ground today contain at least some fiber optic cabling.[11] In other words, under the HTBC proposal, more than one-fifth of the nation's consumers would immediately be denied access to any competitive DSL offerings. Permitting the Bell companies to immediately recapture their network monopolies over such a large percentage of loops will have a predictable effect. As Professor Lawrence Lessig testified to the U.S. Senate:

> "The consequence of total regulatory retreat will be an extraordinary concentration in network ownership, leading to less broadband competition, and higher broadband prices. That concentration will also, in turn, threaten the neutrality of the network, and hence growth and innovation in the broadband network."[12]

Were the Commission to adopt the loop proposals of the HTBC, the Commission would leave consumers with at best a broadband duopoly (ILEC DSL and cable modem) and at worst a broadband monopoly. The Commission has already recognized the

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[8] *Id.* at 5.
[9] 47 U.S.C. § 251(c)(3).
[10] High Tech Broadband Coalition Nov. 6, 2002, *ex parte* at 5.
[11] *See* Initial Comments of Covad Communications Company, WCB Docket No. 01-338, at Joint Decl. ¶ 33 n. 14.
[12] "The Government's Role in Promoting Broadband Deployment," testimony of Professor Lawrence Lessig, Stanford Law School, before U.S. Senate Committee on Commerce, Science, and Transportation, October 1, 2002, at 4, available at http://aei.brookings.org/admin/pdffiles/phpTB.pdf.

consumer harms that result from monopoly or duopoly market control.[13] Indeed, there is no question that a reduction in broadband competition to monopoly or duopoly levels would harm consumers. As the Brookings Institute stated in its most recent broadband economic report:

> "[I]t is difficult to see how freeing [the ILECs] from their sharing requirement will encourage any additional consumers who are not now already signed up for DSL suddenly to embrace the service. In fact, precisely the opposite may occur. If the RBOCs no longer were required to share their facilities, consumers in each market would have, at most, a choice between only two broadband providers: the local RBOC and the local cable company. In such an environment, broadband prices would likely increase, reducing the number of broadband subscribers, or at the very least slowing the rate of the growth of usage."[14]

There is no supportable argument that the loop unbundling obligation, by itself, deters broadband deployment. Indeed, the facts show the opposite to be true – the availability of unbundled loops promotes broadband deployment by incumbents and competitors alike. There is, however, the legitimate issue of ensuring that requesting carriers that seek unbundled access to those loops adequately compensate Bell companies. As discussed below, that important issue is readily addressable by the Commission in the pending Triennial Review.

The Bell companies and their supporters promote the idea that, in the absence of unbundling rules, the Bells will have a commercial incentive to offer wholesale services to their competitors. In the realm of loops, at least one Bell Company has proven that notion wrong. Last week, Verizon informed regulators that it was withdrawing its so-called "PARTS" tariff offering, eliminating the only means by which requesting carriers could access remote terminal-delivered broadband loops. By way of explanation for its decision to eliminate this offering, Verizon informed regulators that "[i]n ongoing broadband rulemaking proceedings, the FCC is considering deregulating advanced services."[15] In short, Verizon was optimistic that it would be successful before this Commission in its efforts to eliminate the obligation that it provide access to loops that contain any fiber facilities. Verizon saw that prospect as an appropriate occasion to withdraw any voluntary offering of access to fiber-fed loops. This tariff withdrawal

[13] *See, e.g.* Statement of Chairman Michael K. Powell on Echostar/DirecTV merger ("The DBS story so far is one of successful, intra-modal, facilities-based competition. This competition has led to more innovation, more programming, and more subscribers; exactly the benefits one would expect. For those who believe, as I do, that these benefits flow from competition between DBS providers, the elimination of that competition, absent a more compelling showing, cannot be squared with the public interest.").

[14] "The Telecommunications Crash: What To Do Now?" Brookings Institution Policy Brief #112 — December 2002, by Robert E. Litan, vice president and director of Economic Studies at the Brookings Institution and the Cabot Family Chair in Economics; former deputy assistant attorney general in the Justice Department's Antitrust Division. Available at http://www.brookings.edu/comm/policybriefs/pb112.htm

[15] *See, e.g.*, Letter dated December 2, 2002, from Joseph A. Post, Regulatory Counsel, Verizon, to the Honorable Joel Linsider, Administrative Law Judge, New York Public Service Commission, at 1.

highlights the simple fact that, in the absence of unbundling, the Bell companies have no incentive to, and will refuse to, deal with their competitors.

The Commission has an opportunity to promote true commercial relations between the Bell companies and their facilities-based broadband competitors. Under the 1996 Act, parties negotiate to implement the Commission's unbundling rules, and only when those negotiations fail are regulators called upon to arbitrate an agreement.[16] Thus, the unbundling obligation brings the parties to the table – carriers are free, and indeed encouraged, to negotiate terms, conditions, and even prices that satisfy their respective commercial interests. Parties can and should reach a commercial deal -- the Act calls for negotiation first, and provides for arbitration only as a last resort. When Verizon withdrew its "commercial offering" for remote terminal loop access, it did so based on its stated belief that the rules would change. Should those rules remain in place with a clearly articulated requirement of fiber-fed loop access, Verizon will be required to negotiate terms and conditions for such access.

The negotiations between incumbents and requesting carriers that can be expected upon the clear articulation of such a requirement will help ensure that the Commission will not have to engineer the telecommunications network, but rather can provide general guidance to ensure that incumbent carriers provide any technically feasible means of access to loop facilities. Indeed, incumbent and competitive carrier parties to the Triennial Review proceeding have advocated very similar architectures for fiber-fed remote terminal loop access. Specifically, the notion of a "bitstream" UNE has dominated the comments of most parties. The bitstream UNE follows on the Commission's longstanding loop unbundling rules, which define a loop not by technology, but by functionality. A loop is a transmission pathway from the end user's premises to the incumbent LEC's serving wire center. That transmission pathway can be made of copper, or fiber, or both, but the material it is made of is irrelevant; what matters is the ability of a requesting carrier to send and receive traffic between collocated equipment in the serving wire center and the carrier's end user. A bitstream UNE allows incumbents to provide technically feasible loop facilities in the manner in which their loop plant is engineered. If the incumbent LEC has installed remote terminal electronics that translate electrical signals travelling on the copper portion of a loop into optical signals for transport over the fiber portion of that loop, the incumbent may wish to simply provide the carrier purchasing that loop with a transmission pathway. So long as the Commission requires the incumbent to provide access to such a loop in any technically feasible manner, the carriers can negotiate the exact means by which the loop will be provisioned. The Commission should embrace the overwhelming evidence on the record that a bitstream UNE is the preferred method of unbundling fiber-fed loops, and adopt rules requiring carriers to negotiate to implement such unbundling.

There is a possibility that carriers will not be able to agree on the price to be paid for such fiber-fed loops – a concern expressed frequently by the incumbent carriers. Here

[16] Section 252(a) of the Act provides that "an incumbent local exchange carrier may negotiate and enter into a binding agreement with the requesting telecommunications carrier or carriers . . . ." 47 U.S.C. § 252(a).

again, the record is replete with suggestions from those incumbent carriers as to how such loops should be priced by state commissions, should a costing proceeding be necessary. The Commission should set out specific guidance to the states to ensure that any such pricing proceeding addresses the argument of incumbent carriers that, absent such concrete guidance to the state commissions, there is a risk that incumbents will not recover the full cost of their investments.

The Supreme Court has recognized the broad authority of state commissions to consider adjustments to factors in the Commission's TELRIC pricing methodology, such as depreciation and capital costs, to account for particularly risky investments.[17] Indeed, the BOCs themselves have promoted shortening depreciation schedules and raising cost of capital factors as the means to protect their incentives to engage in risky investments.[18] The Commission has only adopted very brief guidance regarding the parameters of the TELRIC components, and this proceeding provides an excellent opportunity for the Commission to respond to the Bell company requests for further explanation.

Specifically, the Commission should provide brief guidance to the states regarding four TELRIC components: cost of capital, fill factors, joint and common costs, and depreciation. As to cost of capital, the Commission has concluded that the current rates used by state commissions – authorized rates of return – are merely a "reasonable starting point for TELRIC calculations."[19] The Commission should clarify that, if an incumbent LEC demonstrates with specificity that the business risks that they face in providing unbundled network elements "would justify a different risk-adjusted cost of capital," the state commission should permit such additional recovery.[20] Similarly, fill factors -- the per-unit costs associated with a particular element, derived by dividing the total cost associated with the element by a reasonable projection of the actual total usage of the element -- can be adjusted to ensure any risk of low demand for broadband upgrades is accounted for.[21] Joint and common costs can similarly be clarified to ensure that Bell companies recover fully for any costs directly attributable to the provisioning of bitstream UNEs.[22] Depreciation factors can be adjusted in order to ensure that they "account for expected declines in the value of capital goods."[23] The Bell companies will have every opportunity to demonstrate, if such be the case, that in the case of new technology, depreciation may need to be accelerated to ensure that Bell companies are fully compensated for technical upgrades that may rapidly become obsolete.

[17] "TELRIC rates leave plenty of room for differences in the appropriate depreciation rates and risk-adjusted capital costs depending on the nature and technology of the specific element to be priced." *Verizon v. FCC*, 122 S.Ct. at 1678.
[18] *See, e.g.*, letter dated July 16, 2002, from William Barr, General Counsel, Verizon, to Michael Powell, Chairman, FCC, WCB Docket No. 01-338.
[19] *Local Competition First Report and Order* at ¶ 702.
[20] *Id.* For example, an ILEC might be able to prove that the cost of capital raised to finance the deployment of new network technologies reflected its specific, risk-adjusted cost of capital for deploying those technologies. The ILEC would have to prove to the state commission, among other things, that its higher cost of capital was due solely to the risk associated with upgrading its loop plant.
[21] *Local Competition First Report and Order* at ¶ 682.
[22] *Local Competition First Report and Order* at ¶ 686.
[23] *Id*.

Congress enacted the 1996 Act because it understood the economic realities that motivate a monopoly. As Professor Lessig testified, "[e]very free and competitive market depends on effective regulation. From rules that establish property rights, to courts that enforce contracts, to laws that assure competition is sustained, the government is always intimately involved in guaranteeing the conditions under which innovation and growth occur."[24] In the case of local loops, the Commission has the vital role of ensuring that incumbent carriers cannot exploit their control over bottleneck loop facilities to the detriment of consumers. The Commission need not engineer the network, but it must ensure that the network is open and that competitors can access those elements to which they are legally entitled.

Respectfully submitted,

/s/ Brad Sonnenberg

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cc: Commissioner Michael Copps
Commissioner Kathleen Abernathy
Commissioner Kevin Martin
Commissioner Jonathan Adelstein
William Maher

[24] Lawrence Lessig October 1, 2002, Senate Testimony at 1.